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The Hong Kong Retirement Schemes Association



Sustainable Investment in Pension

11 April 2022 Monday 3:00-4:00pm



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Overview of Sustainable Investing in Pensions

11 April 2022

Jaimee To
Sustainable Investment, Asia Pacific, Mercer

welcome to brighter



Sustainable Investment (SI) at Mercer



2004
—
2006

- RI consulting practices developed and new team formed
- Mercer advises UN on PRI development



2011
—
2013

- Climate Change and Strategic Asset Allocation report
- MMC launches Climate Change Task Force managed by Mercer
- Sustainable Opportunities private markets solution launched

2016
—
2021

- Active & Passive Sustainable Global Equity Funds launched and second Sustainable Opportunities closes
- Mercer represented on FSB Task Force on Climate-related Financial Disclosures (TCFD)
- Investment beliefs updated - strengthened
- Investing in a Time of Climate Change – The Sequel 2019
- Mercer RI PATHWAY 2019



2007
—
2010

- Launches ESG ratings platform for investment strategies
- Publishes many ESG materiality and education papers



2014
—
2015

- Investment beliefs formalized
- Sustainable Growth Framework
- Investing in a Time of Climate Change report released 2015
- ESG ratings for passive equity managers and ratings reach over 4,000 strategies
- Sustainable Investment Policies established for Mercer's Delegated Solutions



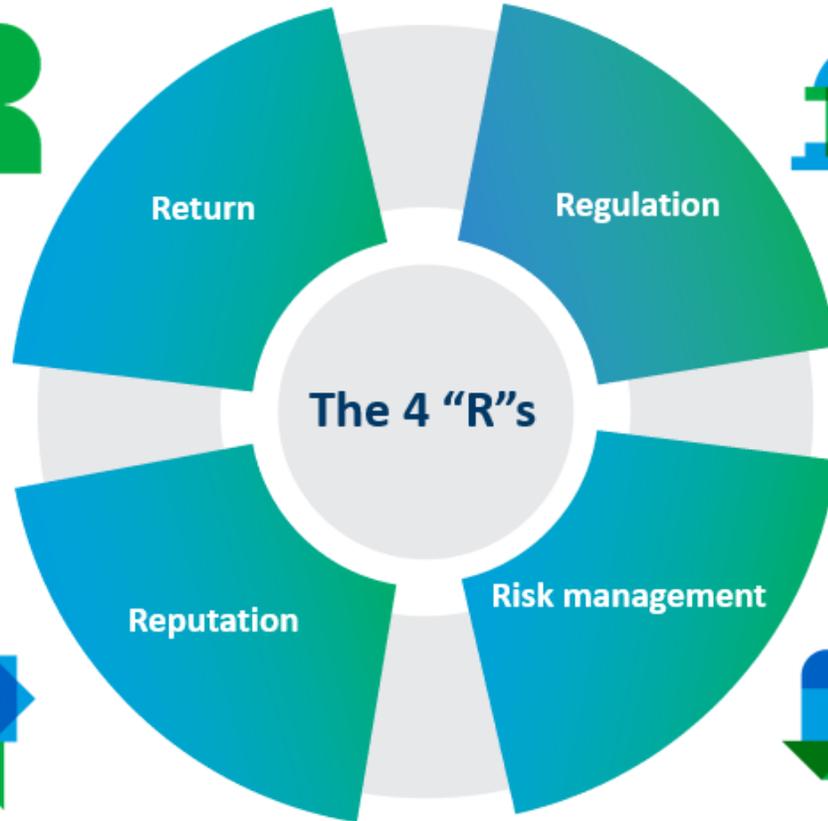
- Mercer's SI team was recognized as the 2021 Investment Consultant of The Year by the Environmental Finance Sustainable Investment Awards

WHY Sustainable Investment in Pensions?

Considering ESG factors as part of the investment process is more likely to lead to **sustainable investment return outcomes** (e.g. a greater ability to sustain paying pensions in the future).



We don't invest in a vacuum and every client has a unique set of stakeholders and organisational values where investment **alignment** may be required.



Global **regulatory intervention is gaining momentum** and is encouraging and requiring sustainability factors to be incorporated into the investment process



ESG risks can have a material impact on financial performance (e.g. is a company heavily reliant on natural resources? Is this factored into the business plan?)

ESG and Returns

Some evidence

CUMULATIVE INDEX PERFORMANCE – GROSS RETURNS (USD) (SEP 2007 – JAN 2022)



Source: MSCI

Note: Past performance may not be indicative of future results.

Observations

- **MSCI ACWI ESG Leaders Index** – one of the ESG index of longest history and broad universe – has demonstrated strong relative performance over the past years.
- It is a representation of ESG-focused portfolios. These portfolios have also proven to be more resilient during the downturns.
- This outperformance is driven by an ESG led sector allocation and a preference towards companies with favorable ESG profiles.

ESG and Risk Management

Environmental Risks Dominate Mid-to-Long Term Horizon



Principles for Adopting Sustainable Investing in the Investment and Risk Management Processes of MPF Funds

Governance

Principle 1

To be in line with their fiduciary duty, mindful of all material financial risks

Principle 2

Trustee's board of directors should have oversight of the ESG integration

Strategy

Principle 3

Incorporation of ESG factors along with all other substantial financial factors

Risk Management

Principle 4

Consider ESG factors with no prejudice

Disclosure

Principle 5

Disclose the MPF Scheme's integration strategies and investment managers' integration policies

Principle 6

Describe how investment managers identify, assess, and manage relevant material ESG factors

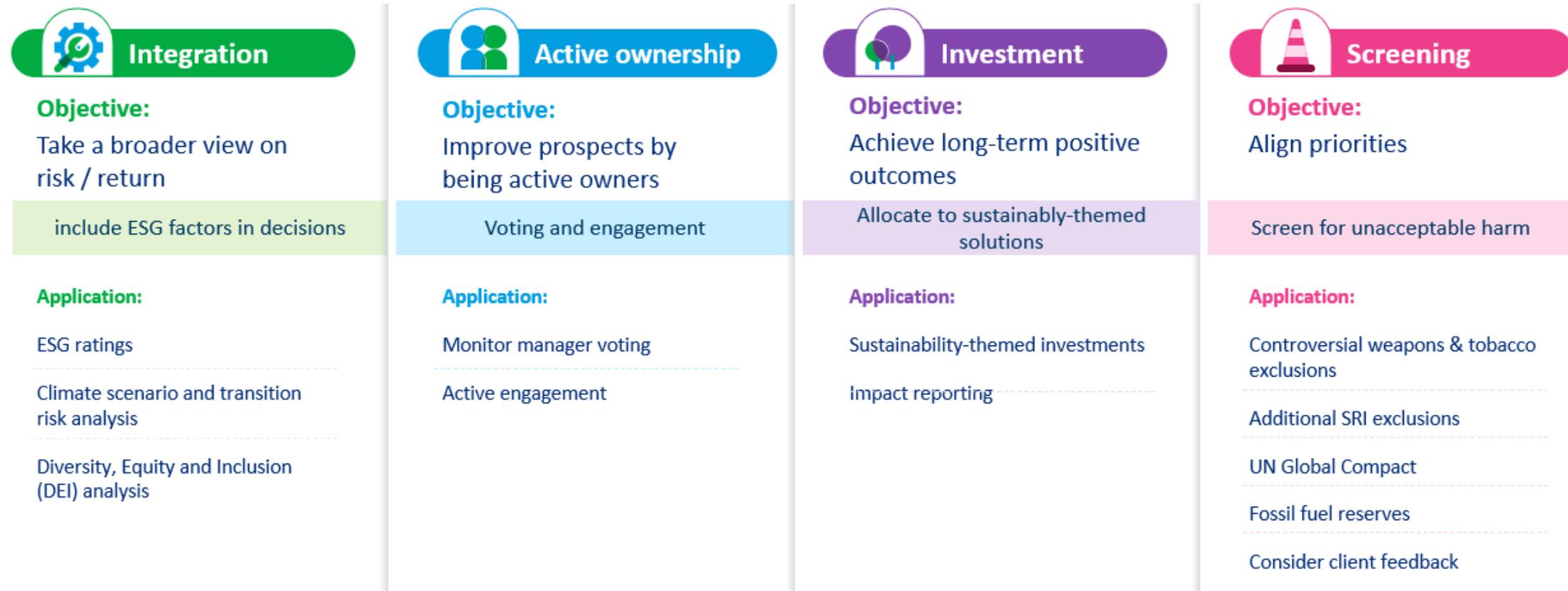
Principle 7

Disclose metrics and targets

What it implies for the industry

WHAT does Sustainable Investing mean?

Our 4 Pillar Approach to Sustainable Investing



Disclosure: Transparency and reporting

Understand the HOW

Moving along the Responsible Investment Pathway

01 Beliefs

- Board beliefs workshop and survey on ESG and climate change
- Trustee education on fiduciary duty, ESG and climate change, and implementation approaches

02 Policy

- Policy, position statements and governance frameworks on ESG and climate change
- Peer comparison of peer policy, public commitments and disclosures

03 Process

- ESG strategy, implementation and asset class guidelines
- Portfolio monitoring framework, benchmark reports and policy compliance
- ESG reporting to stakeholders
- Processes to implement ESG integration, stewardship, thematic investing and screening, as required
- Advice on collaborative engagement with industry associations

04 Portfolio

ESG Integration

- Manager selection and monitoring with ESG ratings
- Climate change analytics, including scenario analysis and carbon footprinting

Stewardship

- Stewardship review
- Voting and engagement and reporting

Thematic Investing

- Sustainability allocation, SDG* and TCFD alignment, impact investing

Screening

- Exposure analysis, including both ESG best-in-class and sensitive investments
- Exclusion decision-making, governance and compliance monitoring

* SDG — Sustainable Development Goals

Importance of Sustainability Monitoring

As a supplement to regular performance reporting



SUSTAINABILITY THEMES: EXPOSURE EXAMPLES



ESG INTEGRATION: RATINGS COMPARISONS



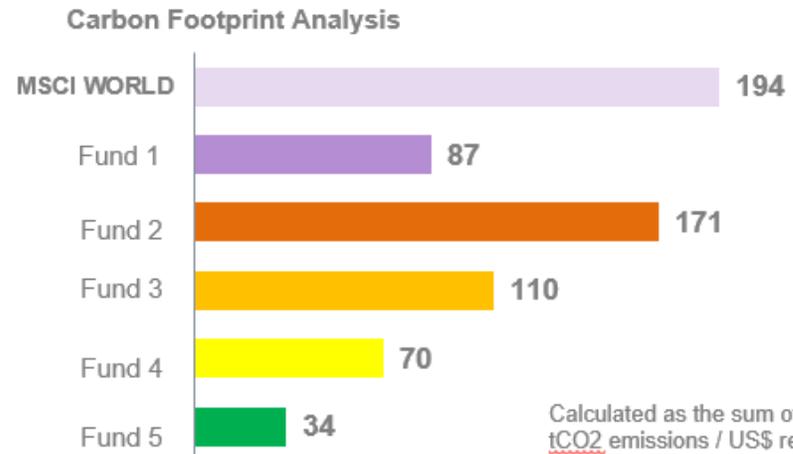
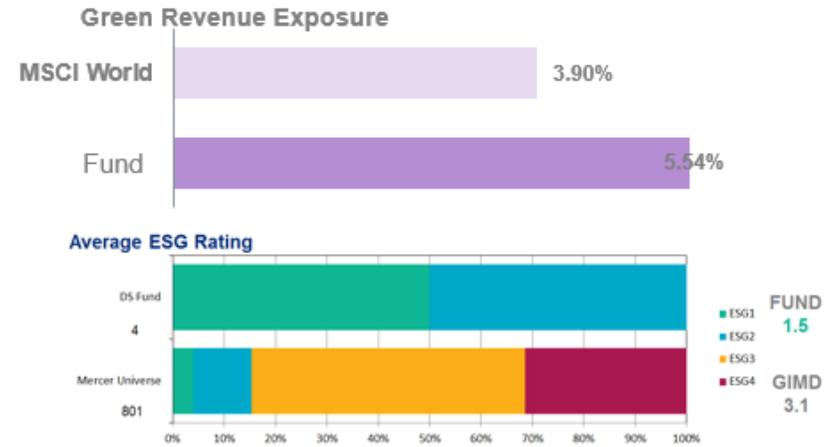
STEWARDSHIP: VOTING AND ENGAGEMENT ACTIVITY



CLIMATE METRICS: CARBON FOOTPRINTING



EXCLUSIONS: COMPLIANCE MONITORING



What are leading global pension schemes doing?

What are leading global pension schemes doing?



Integrating ESG across all asset classes



Allocating to sustainable solutions and impact funds



Focusing on outcomes of their stewardship activities



Collaborating on key ESG mega-themes eg Climate, Diversity



Publishing climate change reports aligned with TCFD



Signing up to the UNPRI

UK example

Enhanced reporting and disclosure



Enhanced Policies in Statement of Investment Principles ("SIP")

- Explicit statement that ESG and climate change are financially material risks;
- Stating *how* trustees undertake stewardship activities (voting and engagement).
- New policies on arrangements with asset managers to focus on longer-term performance and incentivisation.



Engagement Policy Implementation Statement

- Annual statement documenting trustee's investment activity;
- Focus on stewardship activity;
- Summary of voting activity, including significant votes.
- Statement must be published on a public website.
- Included in trustee report and accounts



TCFD* report

- Trustees of schemes with over £5bn of assets will need to comply with the (forthcoming) pension climate regulations and statutory guidance.
- They will need to produce a TCFD statement as at the next scheme year end after 1 October 2021.
- Includes scenario analysis, setting and monitoring climate-related metrics plus setting a target against one metric.

*Taskforce for climate-related financial disclosures

Be an active owner

Case Study: California Public Employees' Retirement System (CalPERS)

- Through engagement and voting on ESG issues, investors exercise influence over portfolio companies to promote long-term value creation for shareholders and beneficiaries.
- CalPERS has developed its **Engagement Prioritisation Framework** to select ESG issues and companies to engage on:
 - **Principles and Policy** – to what extent is the issue supported by CalPERS Investment Beliefs, and Governance/ Sustainability Principles?
 - **Materiality** – does the issue have the potential for an impact on portfolio risk or return?
 - **Definition and Likelihood of Success** – is success likely, in that CalPERS action will influence an outcome which can be measured?
 - **Capacity** – does CalPERS have the expertise, resources and standing to influence an outcome?

Collaborative Engagements

- CalPERS also participated in collaborative engagements with strategic initiatives and objectives linked to investment beliefs with measurable indicators to track success, for example:



An investor-led initiative to engage systemically important greenhouse gas emitters and other companies across the

global economy that have significant opportunities to drive the clean energy transition and help achieve the goals of the Paris Agreement.

Disclosure on climate commitments and progress

Reporting in alignment with the TCFD framework

- The **Taskforce on Climate-related Financial Disclosures (TCFD)** recommends a framework for disclosing how climate-related risks and opportunities are measured, monitored and managed by companies, asset managers and asset owners.

The four core TCFD pillars



Governance

- Review your climate-related investment beliefs
- Prioritise the actions and understand the roles and responsibilities



Strategy

- Consider climate change scenario analysis on investment and funding strategy
- Understand the sponsor's exposure to climate risk and how they are adapting



Risk Management

- Include climate risk in the scheme's risk register
- Asset managers: how are they voting/engaging on climate change?
- Consider sustainable asset allocations
- Consider low carbon or ESG indices



Metrics and Targets

- Carry out carbon foot-printing on equity and corporate bond portfolios
- Consider non-emissions based metrics, such as green revenues
- Consider setting target(s) to manage climate-related risks

Mercer FundWatch™

Sustainable Investment Assessment of Funds
For Individual Investors

11 April 2022

Helen Leung

Mercer FundWatch™ Solutions Leader, Asia

A business of Marsh McLennan

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Global research at a glance

Depth and breadth of our global research resources: 233 staff* directly involved in the research process, and multiple investments professionals globally involved in the research process

Specialised Mercer Alternatives group dedicated to private markets manager research, portfolio management, and investment operations



Three specialist boutiques: equity, fixed income, and diversifying alternatives operating independently but with a consistent philosophy/framework. We believe this provides the benefits of a focused boutique, with the resources of a large, global consultancy

Research specialists have an average of 19 years of experience in the financial services industry**

The majority (60%) of research specialists have an MBA, CFA®, actuarial, masters, and/or relevant qualifications

* Includes central leadership and support/admin staff.

** Average years of experience excludes analysts and support/admin staff.
As at 31 December 2021.

Research investment beliefs

Active management can generate repeatable excess return (although it is rare). Mercer believes the probability of identifying alpha is enhanced by using a manager research process that is:



Research driven

A fundamental, forward-looking, and research-intensive process, which builds on a deep understanding of each investment strategy covered



Repeatable

A robust and consistent framework that assesses each strategy's capabilities in four areas: idea generation, portfolio construction, implementation, and business management*



Evidence based

Focused on characteristics of investment strategies that have been shown to enhance the probability of sustainable alpha generation, which can vary over time, and by the asset class

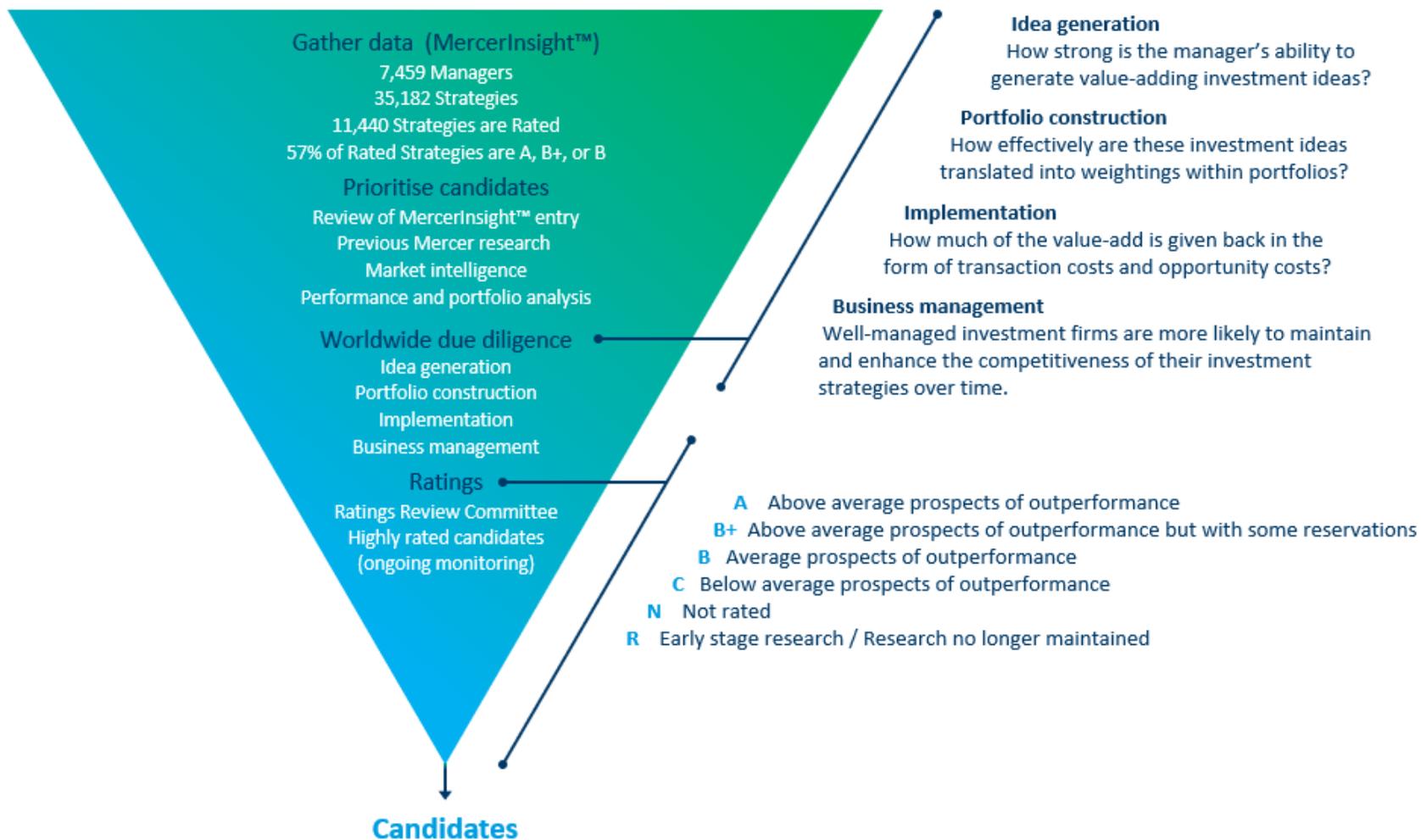


Flexible

There is no single answer – flexibility and experience are required to focus on the relevant characteristics for a given strategy

*Different factors used for certain asset classes such as private markets, LDI and passive.

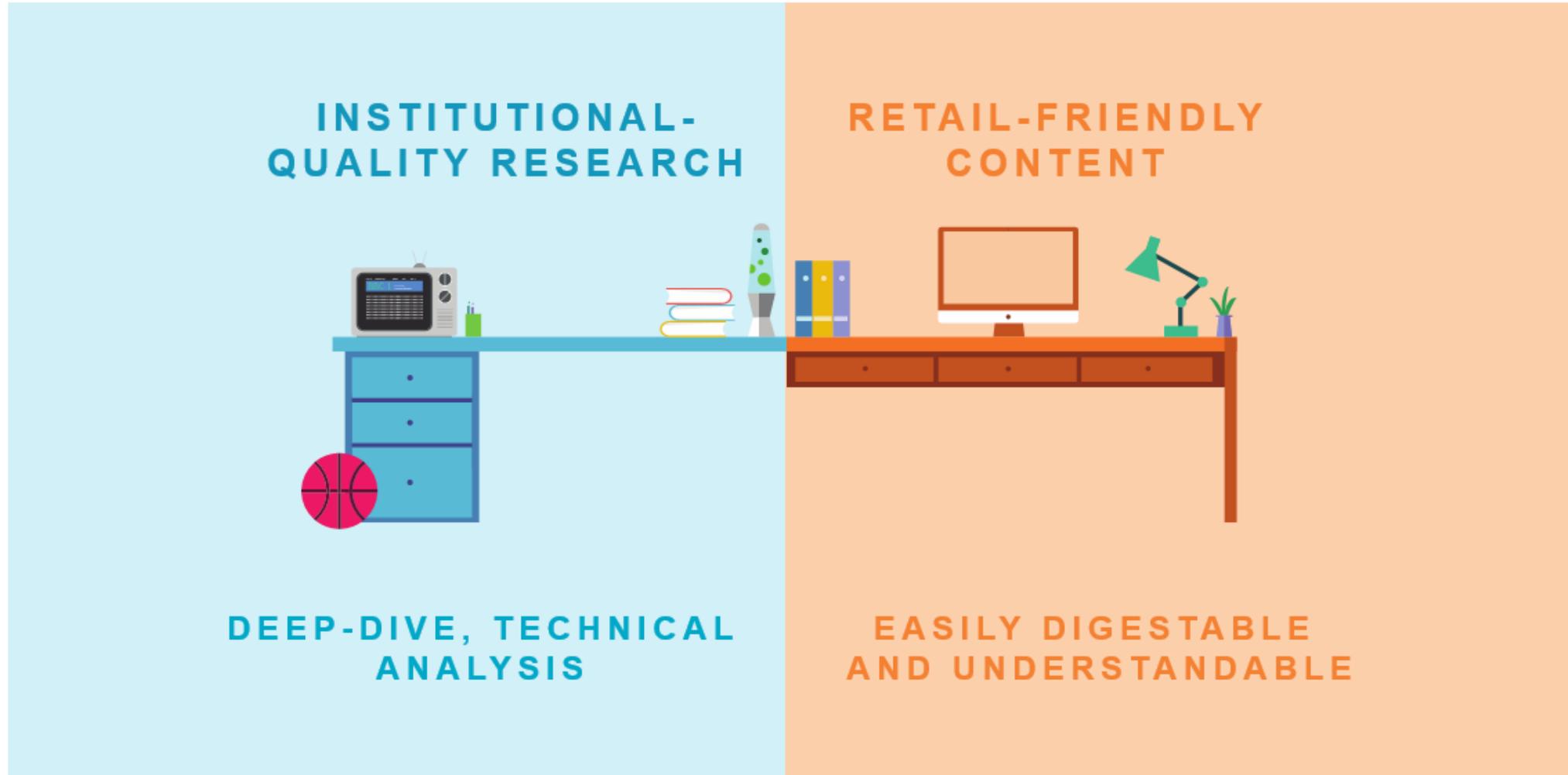
Mercer research process



*Manager and Strategy Statistics as of 31 December 2021, includes sub advised strategies.

Please see the Guide to Mercer's Investment Strategy Ratings <https://www.mercer.com/content/dam/mercer/attachments/private/nurture-cycle/gl-2020-wealth-guide-to-mercers-investment-strategy-research-ratings-mercer.pdf>

Translating institutional quality research to retail-friendly content



Mercer FundWatch™ - 3 Key Features to provide investors with meaningful insight into what really matters



FORWARD LOOKING

- Rating methodology looks forward not backwards
- Qualitative research process undertaken by a 200+ global team of experienced researchers
- No track record required



OUTCOME FOCUSED

- Focuses on the “exposure” a fund provides and how it might be expected to perform
- Net-of-fee future performance prospects



EASILY UNDERSTOOD

- Uses a simple star rating system
- Delivers research in easy-to-understand language



Environmental, social, governance (ESG) factors



Mercer's ESG capabilities



Idea generation

- Efforts to identify and integrate ESG factors into active fund positions as a source of added value
- Identification of material ESG factors - skill of team members, data sourcing



Portfolio construction

- Efforts to integrate ESG driven views into the portfolio's construction



Implementation

- Engagement and proxy-voting activities (if applicable)
- Investment horizon aligns with ability to effectively implement ESG views



Business management

- Firm-level support for ESG integration, engagement activities, and transparency

Our ESG rating scale

ESG1

ESG integrated into investment philosophy; **active ownership a core part of process**

ESG2

Consistent and repeatable process to ESG integration (focus on risk management); **strong evidence of active ownership**

ESG3

Ad-hoc process to ESG integration and active ownership, but **indications of progress**

ESG4

Little or no integration of ESG factors or active ownership into core processes and **no indication of future change**

Please see Mercer's Guide to ESG Ratings <https://www.mercer.com/our-thinking/mercer-esg-ratings.html>

Mercer FundWatch™
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